STATEMENT TO THE

SENATE COMMERCE, SCIENCE AND TRANSPORTATION COMMITTEE

by

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October 30, 2001

The Reinsurance Association of America represents U.S. domestic reinsurers, which collectively
underwrite more than 70 percent of the U.S. reinsurance market. Reinsurance is the insurance of insurance companies. It is the financial mechanism by which insurers spread the risk of loss throughout the world's capital markets. One of the most frequently used purposes of reinsurance is to absorb losses from catastrophic events such as hurricanes, earthquakes, and in the case of September 11, acts of terrorism. Some have estimated that 60 percent of the losses paid by our industry from the events of September 11, will be paid by reinsurers.

The U.S. insurance and reinsurance industry will be able to meet its policy and contract obligations and pay the losses arising out of the September 11 terrorist attacks. Insurers and reinsurers do not need financial assistance from the federal government for those losses, and they aren't asking for any.

The terrorist attacks of September 11, 2001 resulted in unprecedented losses of life, personal injury and property damage. It is difficult to estimate the total injured losses that the U.S. property and casualty insurance and reinsurance industry will ultimately pay as a result of those terrorist attacks. In addition to the normal problems involved in estimating large or catastrophic losses, in this case there may be liability issues that may take time to fully resolve.

Some recent analysts' reports have suggested that $30 billion to $40 billion is a reasonable range of estimated total insured losses (property, casualty, life and health) from the September 1 terrorist attacks. Some analysts have even suggested that the total insured losses could exceed the range of numbers I just mentioned. Put in perspective, the insured losses from the terrorist acts of September 11 could exceed the combined insured losses from the last five major natural catastrophes (hurricanes Andrew and Hugo, the Northridge, California and Kobe, Japan earthquakes and European windstorms Lothar and Martin).

Before September 11, the threat of terrorism within our borders seemed remote. Because of that, no insurance or reinsurance premiums were collected for terrorism coverage, and no assets or reserves were allocated to terrorism exposures. The industry did not underwrite for the risk of terrorism. That means that the September 11 terrorism losses must be paid from the industry's capital account. The total capital and surplus of the U.S. property and casualty insurance and reinsurance industry at June 30, 2001 – including both personal lines and commercial lines writers – was $298 billion. That figure includes $26.6 billion of capital in separately capitalized U.S. domestic professional reinsurers.

That total industry capital consists of required regulatory risk-based capital, as well as the additional capital need to support operating and investment risks and to meet the reasonable expectations of policyholders and claimants, rating agencies, stockholders and others.

The exposure to loss from the September 11 terrorist attacks is not spread evenly across the total insurance industry capital base. The great bulk of those losses will fall on the capital base of the commercial lines insurers and reinsurers.

After subtracting personal lines capital, the Berkshire Hathaway capital that isn't allocated to the affected lines, and the pre-September 11 third quarter declines in common stock values – the affected property and casualty commercial lines insurers and reinsurers (U.S. and non-U.S.) had a September 10 estimated combined total capital base of $126 billion. Tillinghast, in a just-released study for the American Insurance Association, noted that the September 11 losses might rest on an even smaller capital base – perhaps $80billion to $100 billion.

Several conclusions can be drawn from this:

First, the commercial lines capital base can obviously fund a total September 11 insured loss of $25 billion to $40 billion – or an even larger loss from that event.

Second, many actuarial and underwriting principles and practices will have to change. While not a complete list, here are five things that will change:

- We will have new and different notions about the size, shape and trends of insured losses and the required risk loads.
- Most lines of business will require a greater capital allocation.
- Risk-based capital standards will be revised by regulators and rating agencies to incorporate terrorism risk.
- The cost of capital for the insurance business will, other things being equal, go up.
- We need to rethink risk diversification or its opposite, the correlation of risk.

Third, the commercial lines capital base cannot absorb another sizeable terrorist event without seriously compromising the ability of the property and casualty commercial lines industry to meet its commitments for losses arising from other underwriting and balance sheet risks.

The simple fact is that, on its own, the U.S. insurance and reinsurance industry can't afford to take on the potentially unlimited exposure to loss arising from insuring against terrorist acts. No one at present can reasonably predict either the number, scale or frequency of future terrorist attacks we might face before our war on terrorism is won.

We support and applaud the steps that the federal government is taking to combat terrorism. But until those efforts have borne the fruit of significant reduction in the potential for terrorist attacks, it is close to impossible for many insurers and reinsurers to responsibly underwrite or assume terrorism risk. We simply can't evaluate the frequency and severity of terrorism losses using traditional underwriting and actuarial techniques. There are no models that would let us price the risk with confidence.

That is why as an industry we need to explore alternative ways to cover losses arising from terrorism.

The September 24, 2001 edition of The Wall Street Journal featured this quote from Warren Buffet, Berkshire Hathaway's chairman:

> I think in the future, the government is going to have to be the ultimate insurer for acts of terrorism…..An industry with very large, but finite, resources is not equipped to handle infinite losses.

In some very important ways, insurance is the grease that lubricates the American economic machine. Insurance and reinsurance coverage for terrorism risks is necessary for our economic recovery – so that lenders will lend, and builders will build, and employers will hire.

Going forward, we need to find a way to provide insurance against terrorist acts that assures both the continued financial viability of the U.S. insurance and reinsurance industry, and the continued availability and affordability of the wide range of products and services provided.

In a rare – if not unique – show of unity, the property and casualty insurance and reinsurance industries universally agree that the best way to do that is to have the federal government act as the "reinsurer of last resort" for terrorism insurance and reinsurance coverage, similar to the plan used in the United Kingdom.

Federal Reserve Chairman Alan Greenspan appears to agree. On October 17, 2001, he said:

> What hostile environments do is induce people to withdraw, to disengage, to pull back. It's quite conceivable you could get a level of general hostility that would make viable market functioning very difficult … I can conceive of situations [where] the premiums that would be necessary to enable a private insurance company to insure against all those risks and still get a rate of return on their capital would be so large as to inhibit people from actually taking out that insurance ….

> Therefore you're led to what is an unusual conclusion that the viability of free markets on unusual occasions, when you are dealing with violence … [that it is necessary that] the costs of insurance are reinsured by the taxpayers…
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> Free markets and government reinsurance, in this very unusual circumstance they are indeed compatible …
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> (Source: Bloomberg)

It is increasingly clear that state regulators, the Administration, members of Congress, and a broad swath of Americans and American businesses also agree that we need a solution.

All of these interests may not currently agree on the exact way to structure that federal insurer role – we've all heard the several proposals that have been advanced. But there is nearly universal agreement on the fact that this is a significant and urgent problem that needs to be solved before Congress recesses.

While the size and scale of the September 11 terrorist attacks are unprecedented, there are precedents for government involvement – here and abroad – in the solution of temporary insurance market disruptions. The federal government ran an insurance program during World War II. FAIR plans were developed to deal with insurance scarcity in the wake of the 1960's urban riots. More recently, the United Kingdom and other countries have developed government-backed solutions to terrorism insurance.

When the need for these kinds of programs abates, they should be terminated.

We're eager to work with this Committee, other members of Congress, the Administration, state insurance regulators, and others to find a solution that makes sense for the country and for the faltering economy, which badly needs an injection of confidence. The solution must also make sense for policyholders and claimants, for the insurance industry and its regulators, and for you. Insurance is, after all, a critical part of the central nervous system of this economy and this society.

We are not looking for any financial assistance for the insured losses flowing from the tragic events of September 11. We are looking for a way forward to serve our clients by protecting against the financial consequences from acts of terrorism, fulfill our role in the economy, and to protect our solvency.

We believe that a public private partnership premised upon the federal government as a reinsurer of last resort provides the best approach. Legislation creating such a mechanism should clearly define terrorism for this purpose, should establish a framework for regulation of rates for state insurance commissioners and provide the basis upon which insurers retain risk on their own account.

Insurers believe that acts of terrorism have become uninsurable in the traditional sense. Only a public/private partnership, even one that is transitory in nature can address this problem.

I'm grateful for the opportunity to speak to you today, and would be pleased to answer any questions you may have.